

Wholesale markets - Trading conduct

Decision Paper

1 June 2021



Foreword

As kaitiaki of the electricity system the Authority seeks to drive a good compliance culture in the industry to create better outcomes for consumers. To do so, the Authority needs the right rules, the right monitoring and the right consequences. The Code amendment set out in this decision paper represents the final step in the Authority's review of the trading conduct rules.

The question at the heart of this review has been - *when consumers are reliant on one or a few suppliers to meet their demand, does the behaviour of these suppliers support the long-term benefit of consumers?*

The diverse nature of New Zealand's electricity market means that, from time to time, the system relies heavily on one or a small number of suppliers to meet demand. Electricity markets need rules to ensure that parties with the ability and incentive to take advantage of such situations are prevented from doing so. This issue has become starker in recent months as the risk of a dry year increasingly puts pressure on electricity wholesale prices.

Clear, more robust trading conduct rules will encourage better trading behaviour by wholesale electricity market participants, and foster trust and confidence in the wholesale market as the economy transitions to a low-emissions future. The Climate Change Commission highlighted the critical role of the energy sector and the significant role of the electricity sector in contributing towards this transition. This reform will help ensure consumer interests are protected as this transition occurs.

The Authority has received encouraging feedback from market participants during a comprehensive review process where concerns were aired and discussed at length. There were some differing opinions but most stakeholders agree changes are necessary. The Authority will continue to reach out to participants and assist them in understanding the new rule. This has been a process of improvement. I am confident the new rule will support increased trust and confidence and help industry to successfully navigate the future.

The Authority is continuing with efforts to uplift its monitoring capability and capacity, and provide more effective education to support industry compliance. While reviewing the rules, the Authority has also advocated for higher penalties because the Authority does not consider the current penalties send the right message.

The trading conduct reform is a key part of our work to strengthen regulatory settings to incentivise the right market behaviours and decisions, in particular in the wholesale market. This reform will encourage participants to be more transparent and efficient in their trading conduct. Along with reforms in information disclosure, internal transfer pricing and market-making, our work to enhance the wholesale market will collectively help parties be increasingly confident in wholesale market competition, the efficiency of prices and the forward price curve.

On behalf of the Authority, I would like to thank industry participants who have shared their thoughts and opinions, and engaged with the Authority on this important review which will help ensure that long-term consumer interests are promoted. The Authority will continue to work with participants to implement the rule and support industry compliance.

James Stevenson-Wallace

Chief Executive

Executive summary

The Electricity Authority (Authority) has decided to progress with a Code amendment to introduce a new trading conduct rule (rule) into the Electricity Industry Participation Code 2010 (Code) to replace the current 'high standard' of trading conduct provisions.

The rule will require generators and ancillary service agents to ensure that all their offers are **consistent with offers they would have made in a market where no party could exercise significant market power**, irrespective of whether their supply is needed to meet demand or not.

Trading conduct rules are warranted because confidence in the market is undermined if parties can benefit from high prices that are raised to inefficient levels by exercising market power when competitive pressure is weak. Frequent recurrence of these occasions could substantially damage the integrity of the wholesale market and sends the wrong signal to potential new players that could deter them from entering and competing in the market and reduce trust and confidence amongst stakeholders in the market, including consumers.

However, in periods of genuine scarcity, participants should be able to raise offer prices to signal tight supply and support prioritisation of fuel for electricity generation.

Well-functioning electricity markets incorporate mechanisms to prevent the abuse of market power but also allow prices to rise to signal genuine scarcity. The proposed trading conduct rule is intended to achieve this balance of objectives. It would be a key mechanism to improve productive, allocative, and dynamic efficiency in wholesale electricity spot prices in circumstances where competition is weak and improve confidence in the wholesale market for the long-term benefit of consumers.

The proposed rule is based on an economic efficiency framework that is clearer than the current 'high standard' of trading conduct provisions and this approach is more aligned with the Authority's statutory objectives and the intent of having a trading conduct mechanism in the Code.

The Market Development Advisory Group (MDAG) completed their review in December 2020 and made several recommendations for reform, including to replace the current trading conduct provisions with the rule set out in section 1. The Authority accepted the MDAG's recommendations and undertook a full consultation on the proposed Code amendment in February–March 2021.

The Authority has decided to progress with this Code amendment as consulted and after evaluating all the feedback received from submitters. In coming to this decision, the Authority has also considered feedback received in two previous consultations by the MDAG and the findings of the expert evaluation panels.

This decision paper marks the completion of the review of the high standard of trading conduct provisions. The main findings and conclusions from this review are:

- the current high standard of trading conduct provisions are difficult to interpret and apply to the day-to-day trading processes by market participants. They are also difficult to monitor and are prone to being interpreted differently than the economic efficiency framework intended by the Authority;
- the safe harbour provisions could lead to outcomes that are inconsistent with the intended purpose of the trading conduct mechanism in the Code;
- the proposed rule is based on an economic efficiency framework that is clearer for market participants to interpret and is a well understood concept by the Rulings Panel and the courts. This approach is also aligned with the Authority's statutory objective;
- the proposed rule is expected to deliver net overall benefits from fewer instances of inefficient offering behaviour by market participants taking advantage of their significant market power. A clearer rule is also expected to have lower (or similar) compliance and enforcement costs, and lower costs from unintended consequences; and
- the majority of submitters are supportive of the proposal and consider the proposed rule to be superior to the current trading conduct provisions in the Code.

The Authority has decided to amend the Code by repealing the current 'high standard' of trading conduct provisions (clauses 13.5A and 13.5B, and the definition of 'pivotal') in the Code, and introduce the new trading conduct rule set out in section 1. This amendment is intended to come into effect on 30 June 2021.

This decision paper:

- summarises themes from submissions received on the February–March 2021 consultation;
- summarises the Authority's response to these submissions; and
- sets out the Authority's decision in full.

If you have any questions or feedback please contact the project team on tradingconduct@ea.govt.nz.

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1 Decision: Code amendment to improve the trading conduct provisions

1.1. Following consultation in February–March 2021 the Authority has decided to amend the Code by replacing the current trading conduct provisions (clauses 13.5A and 13.5B and the definition of ‘pivotal’) with the following rule:

- (1) In the spot market –
 - (a) it is expected that **offers** and **reserve offers** will generally be subject to competitive disciplines such that no party has significant market power;
 - (b) however, there may be locations where, or periods when, one or more generators, or ancillary service agents, as the case may be, has significant market power.
- (2) Accordingly –
 - (a) where a **generator** submits or revises an **offer**, that offer must be consistent with the **offer** that the **generator**, acting rationally, would have made if no **generator** could exercise significant market power at the **point of connection** to the **grid** and in the **trading period** to which the **offer** relates;
 - (b) where an **ancillary service agent** submits or revises a **reserve offer**, that **offer** must be consistent with the **reserve offer** that the **ancillary service agent**, acting rationally, would have made if no **ancillary service agent** could exercise significant market power at the **point of connection** to the **grid** and in the **trading period** to which the **reserve offer** relates;
- (3) For the purposes of this clause –
 - (a) market power becomes significant when its exercise would have a net adverse impact on economic efficiency, which includes productive, allocative and dynamic efficiency;
 - (b) “spot market” has the same meaning as **wholesale market** except that it excludes the hedge market for **electricity** (including the market for **FTRs**).

1.2. The Authority intends this amendment to the Code to take effect on 30 June 2021.

2 The Code amendment will provide long-term benefit to consumers

- 2.1 Confidence in the market is undermined if parties can benefit from high prices that are raised to inefficient levels by exercising market power when competitive pressure is weak. Frequent recurrence of these occasions could substantially damage the integrity of the wholesale market and sends the wrong signal to potential new players that could deter them from entering and competing in the market and reduce trust and confidence amongst stakeholders in the market, including consumers.
- 2.2 However, in periods of genuine scarcity, participants should be able to raise offer prices to signal tight supply and support prioritisation of fuel for electricity generation.
- 2.3 Well-functioning electricity markets incorporate mechanisms to prevent the abuse of market power but also allow prices to rise to signal genuine scarcity. The Code amendment is intended to achieve this balance of objectives.
- 2.4 This Code amendment would be a key mechanism to improve productive, allocative, and dynamic efficiency in circumstances where competition is weak and will improve confidence in the wholesale market for the long-term benefit of consumers.
- 2.5 The Code amendment is expected to have several positive effects on market outcomes:
- (a) **Build confidence in the electricity market by reducing risk and uncertainty:** a clearer trading conduct rule ensures that participants remain confident in wholesale market competition and this would improve the efficiency of spot and forward electricity prices. The potential consequences of continuing with the status quo would include more frequent inefficient price events.
 - (b) **Improve trust in the market:** an inadequate or ambiguous trading conduct mechanism is less effective at deterring inefficient offering behaviour, and in the longer term, would discourage participation in the market, reduce new entrants and curtail new investment.
 - (c) **Facilitate market monitoring:** a clearer trading conduct rule supported by enhanced monitoring and compliance would help uncover problematic offering behaviour. Improved market monitoring provides assurance to participants about market outcomes and reduces the risk of ad hoc and costly intervention.
 - (d) **Improve security of supply:** by prohibiting the ability of some generators or ancillary service agents from withdrawing supply volumes to raise offer prices, the proposed rule is expected to improve reliable supply to consumers. Supply reliability would also be enhanced because the proposed rule permits participants to raise offers to signal genuine scarcity. This would, in turn, attract new supply sources or the deployment of innovative generation or demand management sources.
- 2.6 The proposed rule is based on an economic efficiency framework that is clearer than the current 'high standard' of trading conduct provisions and this approach is more aligned with the Authority's statutory objectives and the intent of having a trading conduct mechanism in the Code.
- 2.7 The proposed rule will also remove the safe harbour provisions, which over the course of the MDAG's review, were found to possibly be leading to outcomes that are inconsistent with the intended purpose of the trading conduct mechanism in the Code.

- 2.8 In conjunction with the proposed rule, the Authority intends to provide guidance to stakeholders by publishing a series of FAQs that synthesises the MDAG's body of work developed over their review process and publish the Authority's approach to monitoring the proposed rule.
- 2.9 The Authority will also make readily available any decisions by the Rulings Panel or the courts and will consider providing access to anonymised information on other compliance actions not currently made publicly available to further firm up the rule. The proposed rule is expected to better achieve the intended purpose of a trading conduct mechanism in the Code and it is expected to result in net benefits compared to the status quo. The cost-benefit analysis (CBA) appended with the consultation paper concluded that:
- the trading conduct rule is expected to produce greater gross economic benefits than the current provisions.
 - the trading conduct rule is expected to reduce unintended costs and reduce (or at worse have no net effect) on compliance and enforcement costs.
 - because total costs are expected to be lower and gross benefits higher under the trading conduct rule, then net benefits will increase under the rule.

3 The Authority has consulted on the Code amendment proposal

- 3.1 The Authority consulted on the Code amendment in February–March 2021. The consultation paper¹ and stakeholders’ submissions² are available on the Authority’s website. The Authority has considered at length the issues and concerns received from some submitters and has set out its view as further detailed below.
- 3.2 In addition to this consultation, the Authority’s decision was informed by two previous consultations the MDAG undertook with industry participants – a first consultation on a discussion paper issued in February 2020 and a second supplementary consultation paper issued in October 2020.
- 3.3 In their review of the trading conduct provisions, the MDAG obtained advice from two independent evaluation panels consisting of prominent experts in the fields of law and economics³ to act as proxies for the Rulings Panel or courts and apply the current provisions and an initial proposed rule to scenarios based on real world situations. The aim was to test and address the risk that its recommended trading conduct rule would be interpreted differently than intended. The panel findings⁴ reinforced the MDAG’s conclusion that the proposed rule is clearer than the current provisions.
- 3.4 The Authority (and the MDAG) have been reviewing and developing the proposed trading conduct rule for the past four years as part of the continual improvement of the wholesale electricity market. It should be noted that trading conduct is one of the more difficult and complex areas to develop and this is an issue faced by other markets seeking to regulate the behaviour of market participants.
- 3.5 The Authority received seven submissions on the trading conduct consultation from the submitters listed in Table 1. A summary of submissions is provided in Appendix A.

Table 1 – List of submitters

Category	Submitter
Generators/ Gentailers	Contact
	Meridian
	Nova
	Trustpower
Retailers	Haast & Electric Kiwi
	Ecotricity, Flick electric, Pulse Energy & Vocus (jointly as Independent Retailers)
Other	Major Electricity Users Group

¹ Available [online] at: <https://www.ea.govt.nz/assets/dms-assets/27/Consultation-paper-Trading-conduct-v4.pdf>

² Available [online] at: <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/review-of-spot-market-trading-conduct-provisions/consultations/#c18781>

³ The panel members included two former Court of the Appeal judges, former Chairs of the Commerce Commission, a former State Services Commissioner and a former Commerce Commissioner.

⁴ Available [online] at: <https://www.ea.govt.nz/development/work-programme/pricing-cost-allocation/review-of-spot-market-trading-conduct-provisions/development/mdag-high-standard-of-trading-conduct-evaluation-panels-2/>

- 3.6 The majority of submitters were supportive of the Code amendment with five out of seven submitters stating that this proposal is superior to the status quo. The other two submitters supported aspects of the proposal but raised some concerns around the risk and uncertainties that this new trading conduct rule could create.
- 3.7 Some submitters provided several suggestions, and a few raised concerns. These suggestions and concerns have been grouped into the following categories:
- (a) problem definition
 - (b) assessment of options
 - (c) textual drafting to the proposed rule
 - (d) cost-benefit analysis
 - (e) more educational material
 - (f) other feedback:
 - (i) the term “significant market power” is overly broad
 - (ii) risk of multiple and vexatious allegations remains
 - (iii) provide a period of compliance leniency
 - (iv) review the effectiveness of the rule following its implementation
- 3.8 Each of these categories is discussed below.
- 3.9 The Authority has endeavoured to accurately summarise the views expressed in the submissions. However, the summary is not exhaustive and compresses the information provided in submissions. The individual submissions can be read to obtain a full account of submitters’ views.

Problem definition

What the Authority proposed

3.10 The problem definition is set out in the MDAG's recommendations paper⁵ which states that; “[...]at various time and locations, parties have the ability and incentives to exercise significant market power in the New Zealand spot market. Generators are frequently gross pivotal across wide areas of the spot market. [...] the existing HSOTC provisions lack any clear meaning, [...] are opaque and do not necessarily translate at law into the economic efficiency framework assumed to date by the Authority.”

Submitters' views

3.11 In its submission, Trustpower commented that the problem definition was insufficiently established before the MDAG's attention shifted to drafting matters. Although, Trustpower recognised that events have moved on, and their focus is now on the need for transition arrangements (see below).

3.12 In their submission made to the MDAG supplementary consultation in October 2020⁶, Trustpower provided more information on their concerns around the problem definition and asked the following questions:

- Is the MDAG looking for a solution to a situation where the MDAG believes there is currently no competition, some competition, workable competition for the most part, or rarely any competition?
- Does the MDAG consider that the state of competition matters in each half hour at every node or in regions over time?
- Is a regulatory solution preferable to a market one (such as increased demand response or market entry to compete away any excess returns)?

Authority's response

3.13 The Authority considers that problem, as set out by the MDAG, accurately captures the long-standing concern among market participants that some generators are frequently pivotal and have the ability, and incentive, to exercise significant market power that has an economic inefficient outcome.

3.14 The current high standard of trading conduct provisions were added to the Code in 2014 as a 'low-risk', 'light-handed' approach to address this concern. However, it became clear that these provisions were not fit-for-purpose when tested by several cases.

3.15 Since the current provisions were created, the Authority has examined several potential or alleged breaches of the current trading conduct provisions, five of which led to formal investigations, in particular:

- (a) Meridian's offering behaviour on 2 June 2016 where Meridian submitted high offer prices while it was pivotal to prevent constraints forming on the High-voltage direct current (HVDC). The Authority decided this behaviour did not comply with a high standard of trading conduct and issued a warning letter to Meridian but did not lay a formal complaint with the Rulings Panel because it was the first serious test of the

⁵ Available [online] at: <https://www.ea.govt.nz/assets/dms-assets/27/MDAG-review-of-trading-conduct-provisions-recommendations-paper.pdf>

⁶ Available [online] at: <https://www.ea.govt.nz/assets/dms-assets/27/MDAG-supplementary-consultation-on-trading-conduct-v2.pdf>

Code's high standard of trading conduct provisions and its interpretation was still evolving.

- (b) Mercury's offering behaviour on 8 December 2016 where Mercury withdrew reserves which resulted in high final prices for energy and reserves in the North Island. The Authority concluded that Mercury's offering behaviour did not comply with a high standard of trading conduct but did not lay a formal complaint with the Rulings Panel.
- (c) Genesis's offering behaviour between 6-9 August 2018 at Tekapo A when it was 'islanded' (temporarily disconnected from the main grid). The Authority found that Genesis's behaviour did not represent a high standard of trading conduct because it used its pivotal supplier position to cause final prices to be well above the level prices would have been in a non-pivotal situation. Genesis was also not within the safe harbours under clause 13.5B(1) or (3). However, the Authority discontinued the investigation because it deemed that the cost of Rulings Panel proceedings would outweigh the financial harm caused by the breach and further noted that the Authority was proposing to make substantive amendments to the HSOTC provisions.
- (d) Meridian and Contact's offering behaviour during a period from 10 November 2019 when these parties were spilling water in the South Island. The Authority found that based on the information available, Meridian and Contact did not breach the high standard of trading conduct based on findings that the conduct during the period was sheltered by one or two of the 'safe harbour' provisions.

Assessment of options

What the Authority proposed

- 3.16 The Authority considered in-detail various options that were evaluated as part of the MDAG's review and as set out in their discussion paper⁷. The MDAG continued to build upon the findings of its predecessor, the Wholesale Advisory Group (WAG), which had examined concerns around pivotal pricing.⁸
- 3.17 The Authority concluded that a trading conduct mechanism is the best option for the problem that the Authority seeks to resolve namely, to deter the exercise of significant market power in the wholesale electricity market when competition is weak.
- 3.18 The Authority considered both behavioural and non-behavioural options covering a range of approaches – from pro-competitive and operational options to more direct and structural intervention.
- 3.19 In their discussion paper, the MDAG assessed six variations of a trading conduct mechanism and during the review process, the MDAG had evaluated at length several iterations and variations of the rule as suggested by the evaluation panels. The MDAG also undertook a high-level assessment of seven alternative (non-behavioural) options including early gate closure, offer caps, price limits and structural measures.

⁷ Available [online] at: <https://www.ea.govt.nz/assets/dms-assets/26/26404High-Standard-of-Trading-conduct-MDAG-discussion-paper-on-pivotal.pdf>

⁸ Available [online] at: <https://www.ea.govt.nz/assets/dms-assets/15/15953WAG-recommendations-pivotal-pricing.pdf>

Submitters' views

- 3.20 In its submission, Meridian claimed that the Authority:
- (a) failed to adequately consider alternative behavioural options to the proposed trading conduct mechanism and [failed to] assess these options relative to the status quo and the proposal.
 - (b) had moved quickly to endorse the MDAG recommendations without much further analysis of options.

Authority's response

- 3.21 The Authority disagrees with both claims. The MDAG kept the Authority informed throughout the review process and provided comprehensive updates at each major milestone. This includes the MDAG's assessment of alternative options and the rationale for opting to progress with a trading conduct mechanism.
- 3.22 The MDAG also kept the Authority (and market participants) informed of the outcomes from bilateral meetings with stakeholders and on the findings of the evaluation panels, including the lengthy discussions on the various iterations and variations to the rule that the panels proposed.
- 3.23 The Authority considers that the MDAG undertook an appropriate assessment of alternative options. The Authority is confident that the proposed trading conduct rule achieves the right balance between preventing the exercise of significant market power when competition in the wholesale spot market is weak but also allow prices to increase to signal genuine scarcity.
- 3.24 The Authority considers that options involving direct intervention in the market (be it through offer or price caps or structural measures) would be unduly prescriptive and more administratively complex and costly to implement when compared to the apparent problem they seek to resolve.
- 3.25 However, the Authority will reconsider these options if the proposed trading conduct rule is not effective at deterring the exercise of significant market power in the wholesale electricity spot market when competition is weak.

Textual drafting to the proposed rule

What the Authority proposed

- 3.26 The Authority is proposing to replace the current high standard of trading conduct provisions (clauses 13.5A and 13.5B and the definition of "pivotal") in the Code with the proposed rule set out in paragraph 1.1 above.
- 3.27 Clause (1) is emphasising a statement of fact about the spot market and it is intended to provide context to the core test set out in clause (2).
- 3.28 Clause (2) sets the test on trading conduct behaviour expected by the Authority, namely that *"where a generator and ancillary service agent submit or revise an offer, that offer must be consistent with the offer that the generator, acting rationally, would have made if no generator could exercise significant market power at the point of connection to the grid and in the trading period to which the offer relates"*.

- 3.29 Clause (3) defines when market power becomes significant i.e. when its exercise would have a net adverse impact on economic efficiency, including productive, allocative and dynamic efficiency. This clause also defines the ‘spot market’ and excludes the hedge markets from the requirement set by this rule.
- 3.30 The proposed Code amendment rests on a clearer economic efficiency framework than the current provisions and is expected to be more easily understood and implemented by market participants. It is expected to improve the efficiency of wholesale electricity spot prices in situations where one or more market participants can exert significant market power. This will help to promote the three limbs of the Authority’s statutory objective—competition, reliability, and efficiency—for the long-term benefit of consumers

Submitters’ views

- 3.31 The Independent Retailers, Meridian and Trustpower suggested amendments to the proposed rule, as summarised in Table 2 below and reproduced in full in Appendix B.

Table 2 – Summary of suggested amendments to the proposed rule

Submitter	Suggested Amendment
Independent Retailers	The test of when market power becomes significant should include “or otherwise cause harm to consumers” to link the definition of when market power becomes significant more closely to all three limbs of the Authority’s statutory objective.
Meridian	(1) Delete “it is expected” from clause (1)(a) to improve the drafting and avoid imbuing the Code with sentiments. (2) Replace "at the point of connection to the grid and in the trading period to which the offer relates" with “in the relevant market” to avoid an overly narrow definition of market. (3) Delete clause (3)(a) because it is awkwardly drafted in that it seeks to define significant market power by reference to (non-significant) market power, in a manner that is inconsistent with the case law relating to the definition of a market, or identification of a position of market power in that market.
Trustpower	Replace sub-clauses (1)(a) and (b) with a single clause that tests whether offers are subject to competitive disciplines because: <ul style="list-style-type: none"> • the word “Accordingly” only applies to clause 1(b), and yet the sentence structure might suggest it applies to both sub-clause 1(a) and 1(b); • other sections of the Code may also rely on the assumption in sub-clause 1(a) and its express inclusion might have implications for the future interpretation of those other sections.

Authority’s response

- 3.32 The Authority has evaluated at length the amendments to the proposed rule suggested by some submitters but concluded that the proposed rule, as currently drafted, best delivers the policy intent.
- 3.33 The Authority’s response to each of the suggested amendments is set out in more detail below.

The Authority's response to the Independent Retailers' suggested amendments to the rule

- 3.34 The Authority understands that adding the text “or otherwise cause harm to consumers” as a ‘catch all’ to the rule would provide a certain level of comfort. However, including this broad statement could have the unintended consequence of assigning a wider level of coverage to the rule than intended by the Authority. This would risk making it unworkable in practice and leave it open to contend with situations for which it is ill-suited to address.
- 3.35 Furthermore, including this term also adds a problematic layer of ambiguity because “harm to consumers” beyond the impact of artificially high prices is a nebulous concept.
- 3.36 The Authority reiterates that the central objective of the rule is to improve price efficiency in the wholesale spot and ancillary services market. If the market is shielded from adverse effects on economic efficiency, that should ultimately also benefit consumers.

The Authority's response to Meridian's suggested amendments to the rule

- 3.37 The Authority is aware of Meridian's concern that the proposed rule is (perceived) to have an overly narrow application and recognises that Meridian's suggested changes to clauses 2 and 3 are an attempt at addressing this concern.
- 3.38 However, when taken together, Meridian's suggested changes would substantially dilute the effectiveness and coverage of the proposed rule, as further explained in the following sections.
- 3.39 The use of “it is expected” in sub-clause (1)(a) in its passive tense refers to the expectation in the spot market and this term is used to highlight a key underlying assumption ie, that offers in the spot market will generally be subject to competitive disciplines. This statement should not be misconstrued as referring to the expected offer behaviour of any specific participant or participants.
- 3.40 The use of “at the point of connection to the grid and in the trading period to which the offer relates” in clause (2) is specifying the locations and periods when the offer is subject to the rule. This makes it clear when and where the rule applies. Replacing this statement with ‘in the relevant market’ as suggested by Meridian would leave it open to different interpretations by different parties. This raises the risk of being interpreted differently to what is intended by the Authority and could lead to unnecessarily long-drawn and expensive litigation.
- 3.41 The Authority recognises that removing the definition of market power has some attraction because it would arguably lead to greater simplicity and consistency (with the Commerce Act).
- 3.42 However, the Authority considers it important to provide direct reference to when market power becomes significant as set out in Clause (3)(a). Specifying that the proposed rule relates to the exercise of market power is appropriate, as a party that is able to exercise market power in a manner that is detrimental to economic efficiency at levels of aggregation beyond the node at which they are operating will also have the ability to do this at its individual node.
- 3.43 Furthermore, an enquiry under this proposed rule will inevitably involve a consideration of market power in the ordinary sense (ie. in the way it is approached under the Commerce Act). This is inherent in the concept of market power and it therefore needs to be considered.

- 3.44 The Authority points out that proposed rule does, however, allow consideration of wider effects as breach of the rule is only possible when there is a net adverse impact on economic efficiency.

The Authority's response to Trustpower's suggested amendments to the rule

- 3.45 Trustpower suggested to replace sub-clauses (1)(a) and (b) with a single clause that would test whether the offer is subject to competitive disciplines, and if not, then the core test in clause (2) would apply. The rationale for this suggestion is because the term "Accordingly" in clause (2) could be misconstrued as applying to both sub-clauses (1)(a) and (b) when it only applies to sub-clause (1)(a); and that the 'assumption' in sub-clause (1)(a) could have implications for the future interpretation of other sections in the Code.
- 3.46 The Authority understands that the rationale for this proposal is to make it clearer when the obligation in Clause (2) applies. However, the trading conduct rule is intended to be universal i.e. they apply at all times when offers or reserve offers are submitted or revised. Therefore, there is no need to define when they apply.
- 3.47 The Authority further notes that Trustpower's proposed change seems to be setting a new test to the rule, namely whether there is sufficient competition in the market when the offer (or reserve offer) is made. This would appear to be akin to a safe harbour whereby if no generator (or ancillary service agent) has significant market power (or is not pivotal) when the offer is made (or revised), then the test in clause (2) will not apply. This is not the Authority's intention. The test set out in clause (2) - would apply irrespective of whether that generator was subject to competition or not.
- 3.48 The Authority stresses that the purpose of clause (1) is to highlight an underlying assumption that provides context to the core test set out in clause (2). This provide useful background to the Rulings Panel or a court on how it should approach the interpretation of the core test, and this would mitigate the risk that the rule is interpreted differently than intended by the Authority.
- 3.49 Since clause (1) is not setting any additional test or requirement on generators or ancillary service agents, it will not restrict the future interpretation of other sections of the Code.

Cost-benefit analysis

What the Authority proposed

- 3.50 The Authority's cost-benefit analysis (CBA)⁹ assesses the direction of change in costs and benefits of the proposed rule relative to the status quo (the current provisions). It sets out the rationale for this assessment and supports it through a quantitative estimate of the potential gross benefits from the proposed rule through avoiding inefficient investments by parties seeking to avoid high prices by local pivotal suppliers.

⁹ See Appendix D of the Consultation Paper [online] Available at: <https://www.ea.govt.nz/assets/dms-assets/27/Consultation-paper-Trading-conduct-v4.pdf>

- 3.51 In particular, the CBA explains that rational purchasers will take steps to avoid purchasing electricity at a high price when the pivotal supplier raises prices during periods when it is pivotal, such as by purchasing a battery. This is because the avoided cost of electricity bought at a high price would far outweigh the cost of the battery. In the scenario examined in the CBA, this inefficient investment would result in a cost (to society) of \$0.8m per year or a net loss of \$8m in present value terms. This result is similar to the findings of the MDAG's initial CBA in their discussion paper which had estimated a potential benefit of \$7.64 million in present value terms for a similar scenario.
- 3.52 The CBA further shows that ineffective trading conduct provisions could encourage over-investment in supply capacity, and that an over-investment of just 0.5% in unnecessary capacity would result in an efficiency cost of \$40m to \$60m in present value terms.
- 3.53 The conclusions of the CBA are that:
- (a) the proposed trading conduct rule is expected to produce greater gross economic benefits than the current rule.
 - (b) the proposed trading conduct rule is expected to reduce unintended costs and reduce (or at worse have no net effect) on compliance and enforcement costs.
 - (c) because total costs are expected to be lower and gross benefits higher under the proposed trading conduct rule, then net benefits will increase under the proposed rule.

Submitters' views

- 3.54 Meridian argues there is a significant risk of unintended consequences that has not been accounted for in the cost benefit analysis. Meridian says the Authority's analysis assumes *"the proposal will not deter any efficient behaviour. For that claim to be true, investigations by the Authority and decisions by the Rulings Panel would need to always result in and incentivise more efficient market prices than would result from price discovery in the market, and all generators would need to be confident ex ante how the rules would be applied in any given situation so that they could act accordingly. Such a claim assumes perfect decision making by enforcement bodies and perfect foresight from generators"*.¹⁰

Authority's response

- 3.55 Meridian has misinterpreted the Authority's cost benefit analysis. It does not assume perfect decision making by enforcement bodies and generators. On the contrary, the Authority recognises the potential for unintended effects to arise with any rule.
- 3.56 However, what matters is whether the scope for unintended harm is enlarged or reduced by the proposed rule compared to the current rule. Meridian's submission seems to overlook the potential for harm under the existing rule. In the Authority's opinion, this potential is very significant and many participants share this view. Indeed, Meridian has previously described the existing rule as "too vague to be useful or easily understood by participants" and it judged the rule to be "unworkable".¹¹ In the Authority's view, the proposed rule has much less scope for harm than the existing rule because the latter is vague and not framed in economic efficiency terms.

¹⁰ Meridian Energy submission 23 March 2021, at page 8.

¹¹ Meridian Energy submission to MDAG of 4 May 2020, at pages 3 and 1 respectively.

- 3.57 On a related issue, Meridian stated *“the definition of significant market power is about whether the exercise of market power would have a net impact on economic efficiency – it therefore has no regard to the costs of intervention.”* [emphasis in original]¹².
- 3.58 Meridian is not correct that the cost of intervention has been disregarded. The proposed rule requires enforcement authorities to consider whether there are offsetting positive economic efficiency effects arising from an alleged exercise of market power (from the use of ‘net adverse impact’ in clause (3)(a)). If the combined efficiency impact is zero or net positive, then no enforcement action could proceed. In this regard, the ‘cost of intervention’ has been taken in account.

Provide more educational material to market participants

What the Authority proposed

- 3.59 Over the course of the review of the trading conduct provisions, the MDAG developed a substantial body of work that explains the policy aim and the rationale for proposing the rule. This body of work includes a discussion paper, a supplementary consultation document, a recommendations paper and the findings of the evaluation panels. Taken together, these documents provide guidance to market participants on the intended meaning and interpretation of the proposed rule.
- 3.60 During the review process itself, the MDAG engaged with stakeholders at each major milestone to explain its rationale for making certain decisions and to seek feedback. A detailed timeline on the MDAG’s review process is found in their recommendations paper¹³.
- 3.61 The Authority also offered to meet stakeholders during the consultation period to answer any queries on the proposed rule and to allay their concerns including on how to apply the rule to the day-to-day trading processes.
- 3.62 To further guide stakeholders, the Authority intends to publish its approach to monitoring the proposed rule and will synthesise the MDAG’s documents listed above in a series of FAQs on the Authority’s website. The Authority will also make readily available any decisions by the Rulings Panel or the courts.
- 3.63 Additionally, the Authority will consider providing access to anonymised information on other compliance actions not currently made publicly available to further firm up the rule.
- 3.64 The Authority does not intend to provide hypothetical scenarios in a guiding document because, as previously stated by the MDAG: *“a “black and white” manual is impossible to compile given the almost infinite number of cases and permutations without necessarily answering the next fact situation that a trader may be dealing with”*. There is no clear cut boundary that establishes when an offer complies or does not comply with the proposed rule, and this depends on the particular circumstances when the offer is made.
- 3.65 The Authority encourages market participants to familiarise themselves with the substantial body of work developed during the review of the trading conduct provisions and to seek their own legal and economic advice to correctly apply the rule to their internal trading processes.

¹² Meridian Energy submission 23 March 2021, at page 7.

¹³ See MDAG’s Recommendations Paper at page 7 [online] Available at: <https://www.ea.govt.nz/assets/dms-assets/27/MDAG-review-of-trading-conduct-provisions-recommendations-paper.pdf>

Submitters' views

- 3.66 Meridian stated that there is value in the Authority considering the application of the rule in practice.
- 3.67 Trustpower considers there is still some uncertainty as to how the proposed rule will apply from a trading desk perspective and that moving to this rule will require significant learning and/or adaptation.
- 3.68 Trustpower considers that the publication of case studies would help provide clarity as to what would constitute a breach of the new trading conduct rule and assist with addressing these identified uncertainties.
- 3.69 Trustpower strongly supports the Authority further considering the associated transitional arrangements, including: provide further education to the market around how the new arrangements are intended to operate and provide for a period of compliance leniency once the new rule comes into force (further discussed below).

Authority's response

- 3.70 The Authority supports Trustpower's suggestion to provide further educational material to the market and will continue to reach out to participants to answer any queries or address their concerns on the interpretation or application of the rule. The Authority is also considering holding workshops or, as suggested by Trustpower, training sessions similar to the real-time pricing arrangements.
- 3.71 However, the Authority stresses that the rule itself is self-contained and its meaning is encapsulated within its clauses. Therefore, any educational material would necessarily be of a high-level to avoid re-interpreting the rule differently than intended and create the risk that this material supplants the rule itself.
- 3.72 In the interim, the Authority is confident that the material listed in paragraphs 3.62 - 3.63 will provide the required guidance to help stakeholders to interpret the rule and apply it to their day-to-day trading processes.

Other feedback

(1) The term “significant market power” is overly broad

What the Authority proposed

- 3.73 The core test in clause (2) is that: *“offers must be consistent with the offer that the generator, acting rationally, would have made if no generator could exercise significant market power at the point of connection to the grid and in the trading period to which the offer relates”*.
- 3.74 The rationale for using “significant market power” as the yardstick in the rule is because although market power is ubiquitous and it is necessary for price discovery, what ultimately matters is the degree to which prices can be influenced by one party or a group of co-ordinating parties, or the degree to which prices can be set above some measure of economic costs¹⁴.

Submitters’ views

- 3.75 In their submission, Meridian argued that the definition of significant market power is overly broad as it has no countervailing costs of intervention threshold to overcome and all market power is significant because exercising market power even a little would have an adverse impact.

Authority’s response

- 3.76 The Authority understands why Meridian is interpreting clauses 3(a) as being a broad definition of market power. However, the Authority disagrees with Meridian’s statement that *“all market power is significant because exercising market power even a little would have an adverse impact”*. Sub-clause (3)(a) defines the conditions when market power becomes significant as *“when its exercise would have a net adverse impact on economic efficiency, which includes productive, allocative and dynamic efficiency”*.
- 3.77 Therefore, as stated in paragraph 3.58, the combined efficiency impact will need to be ascertained before proceeding with any enforcement action. This ‘efficiency impact’ would be ascertained by considering both positive and negative economic efficiency effects arising from an alleged exercise of market power. If this combined impact is zero or net positive, then no enforcement action could proceed.
- 3.78 If the market participant provides evidence that the offering behaviour causing an alleged breach has resulted in productive, allocative and dynamic efficiency benefits that outweigh the costs of this behaviour, then it would not meet the ‘breach’ threshold and would realistically be expected not to be progressed further.

(2) Risk of multiple and vexatious allegations remains

What the Authority proposed

- 3.79 The Authority is proposing to replace the current trading conduct provisions with a new rule because, as observed by the MDAG, these provisions are difficult to interpret and apply to the day-to-day trading processes by market participants; and the safe harbour provisions could lead to outcomes that are inconsistent with the intended purpose of the trading conduct mechanism in the Code.

¹⁴ See MDAG’s Discussion paper at paras 119-123 [online] Available at: <https://www.ea.govt.nz/assets/dms-assets/26/26404High-Standard-of-Trading-conduct-MDAG-discussion-paper-on-pivotal.pdf>

3.80 The proposed rule is clearer than the current provisions because it is based on an economic efficiency framework and it is more aligned with the Authority's statutory objectives and the intent of having a trading conduct mechanism in the Code.

Submitters' views

3.81 In their submission, Trustpower remains of the view that there is a real risk of multiple and vexatious allegations, as detailed in their previous submission to the MDAG supplementary consultation.

3.82 In the MDAG supplementary consultation, Trustpower claimed that the proposed rule could lead to a proliferation of complaints until interpretations were settled (by the Rulings Panel or courts).

Authority's response

3.83 The Authority considers this prospect to be remote because clause (2) of the proposed rule makes it clear that the conduct provisions are intended to act as a backstop rather than supplanting normal competition.

3.84 The Authority has some level of discretion in deciding whether to progress any alleged breach to a full investigation. It would only do so if it considered that a claim had solid grounds and it is *prima facie* clear that the offering behaviour had a net adverse impact on economic efficiency.

(3) The Authority should consider providing a period of compliance leniency

What the Authority proposed

3.85 The Authority did not offer to provide a period of compliance leniency in any of its consultations and meetings with stakeholders. Similarly, the MDAG did not consider this as an option during its review of the trading conduct provisions.

Submitters' views

3.86 Trustpower suggested that the Authority consider appropriate transitional arrangements by providing further educational material and by providing a period of compliance leniency when the new rules come into force.

3.87 Trustpower quoted the Authority's statement in the consultation paper that "*there may be a temporary increase in the number of alleged breaches and investigations during the initial "bedding in" period*". During this period, Trustpower supports the Authority working directly with participants to improve understanding of the new arrangements in the first instance, rather than immediately moving to enforcement actions where a compliance breach has been identified.

3.88 Trustpower suggested that in determining an appropriate commencement date for when the new rule enters into force, the Authority should allow time for market participants to seek expert advice on this new rule to ensure they follow it appropriately. At a minimum, three months will be required to enable this advice to be procured and adapted into internal guidelines or processes.

Authority's response

3.89 The Authority agrees with Trustpower's suggestion that the Authority should work directly with participants to improve understanding of the new arrangements. The Authority is considering several educational materials as listed in paragraphs 3.62 - 3.63.

- 3.90 The Authority strongly disagrees with Trustpower to allow for a minimum three-month compliance leniency period, and as stated by Trustpower; *“refrain from proceeding to enforcement actions where a compliance breach is identified”*. The Authority points out that the harm to consumers from trading conduct breaches could be substantial (a clear example is the 2019 UTS¹⁵) and the Authority has the responsibility under the Act to protect the interests of consumers.
- 3.91 The Authority notes that market participants have known for several months of the Authority’s dissatisfaction with the current high standard of trading conduct provisions and its intention to amend them. The Authority considers that participants will have sufficient time to setup or review their internal processes to ensure that their offering behaviour does not breach the new rule.
- 3.92 Participants should be aware that the Authority has a measure of discretion in investigating and enforcing compliance as set out in the Authority’s Enforcement and Prosecution Policies¹⁶. The Authority takes into consideration factors such as whether it is a first-time breach of the new rule, the seriousness of the breach allegation, and the potential for harm to consumers.

(4) Review the effectiveness of the rule following its implementation

What the Authority proposed

- 3.93 The Authority is confident that the proposed rule is an improvement on the status quo and would be more effective at deterring the exercise of significant market power in the wholesale spot and ancillary services market when competition is weak.
- 3.94 To support the implementation of this rule, the Authority intends to strengthen its monitoring, enforcement and compliance functions as a matter of priority.
- 3.95 The Authority will strengthen its monitoring functions first by focussing on upgrading its monitoring capabilities to enable it to carry out the level of scrutiny required under the proposed rule.
- 3.96 The Authority will also strengthen its compliance and enforcement functions by allocating additional financial resources and by continuing to engage with Ministry of Business, Innovation and Employment (MBIE) to review the current penalty regime for breaches of the Code provisions

Submitters’ views

- 3.97 In their submission, Major Electricity User’s Group (MEUG) recommended that the Authority should consider measuring whether the increased surveillance [monitoring] costs incurred by the Authority and the regulatory costs incurred by affected participants are adding value to the long-term benefit of consumers.
- 3.98 Alternatively, MEUG recommended the Authority to undertake a post implementation review of the Code amendment following two or three years after the rule comes into effect.

¹⁵ Available [online] at: [online <https://www.ea.govt.nz/code-and-compliance/uts/undesirable-trading-situations-decisions/10-november-2019/>]

¹⁶ Regulation 11(1)(c) of the Electricity Industry (Enforcement) Regulations 2010

Authority's response

- 3.99 The Authority agrees with MEUG that a post implementation review of the Code amendment should be undertaken. The Authority intends to do so after the first six to twelve months from when the new rule comes into effect.
- 3.100 This review may include an assessment of the additional monitoring costs incurred by the Authority relative to the benefits obtained by consumers from implementing the proposed rule. As stated in the CBA, the costs to participants were deemed to be minimal because they should already have systems in place to ensure that their offering behaviour complies with the current high standard of trading conduct provisions.

4 Next steps - implementation of decisions

- 4.1 The Code amendment will be effective from 30 June 2021. The Authority expects market participants to have reviewed their internal processes by this date to ensure that their offering behaviour is aligned with the intended outcomes of the new trading conduct rule.
- 4.2 On this date, the Authority will also publish the methodology it proposes to use to monitor compliance - including how the Authority will identify questionable offering behaviour and how to determine whether offers of concern merit further investigation.
- 4.3 Throughout 2021, the Authority will continue to implement the supporting measures. The monitoring functions will be strengthened first and additional resources will be allocated to upgrade the analytical capabilities and enable a greater level of scrutiny as required by the proposed rule.
- 4.4 The Authority's compliance and enforcement capabilities will also continue to be strengthened. A well-resourced compliance team would enhance the Authority's investigative capabilities and be better equipped at uncovering problematic offering behaviour so timely and effective action can be taken.
- 4.5 The Authority will continue to engage with MBIE to review the current penalty regime for breaches of the Code provisions as part of the wider programme to review the Act. Section 54 of the Act stipulates a maximum penalty for Code breaches of not more than \$200,000 per breach. The Authority considers that the current penalties in the Act do not reflect the potential gains from abuses of significant market power or the cost imposed on other market participants and consumers.

Appendix A Summary of submissions

A.1 The Authority has sought to address the main issues and concerns raised by some submitters during the February-March 2021 consultation. A summary of submissions, together with the Authority’s response is provided in Table 3 below.

Table 3 – Summary of submissions

Submitter	Submitter feedback	Authority’s response
Trustpower	Problem was not properly defined	<p>The Authority disagrees that it did not properly define the problem. The problem definition is set out in the MDAG’s recommendations paper and reproduced in paragraph 3.10 above.¹⁷</p> <p>The Authority recognises that market forces could theoretically resolve any abuse of significant market power — in the form of innovation and new market entrants – but a material period would pass before this is effective in curtailing market power, with substantial economic harm in the meantime. The Authority does not consider this acceptable and it is paramount that trust and confidence in the wholesale electricity market is safeguarded for the long-term benefits to consumers</p>
Meridian	Alternative behavioural options have not been adequately considered	<p>The Authority assessed several options as put forward by the MDAG, and previously, by the WAG. In their discussion paper,¹⁸ the MDAG considered six variations of a trading conduct mechanism and several iterations and variations of the proposed rule.</p> <p>The MDAG had also evaluated seven alternative (non-behavioural) options but these were considered to be unduly prescriptive and more administratively complex and costly to implement when compared to the apparent problem they seek to resolve.</p>
Meridian	The definition of significant market power is overly broad as it has no countervailing costs of intervention threshold to overcome and all market power is significant because exercising market power even a little would have an adverse impact.	<p>Clause (3)(a) defines the conditions when market power becomes significant as “<i>when its exercise would have a net adverse impact on economic efficiency, which includes productive, allocative and dynamic efficiency</i>”. Therefore, the combined efficiency impact of both the positive and negative economic efficiency effects arising from an alleged exercise of market power will need to be considered before proceeding with any enforcement action</p>

¹⁷ See MDAG’s Recommendations Paper [online] Available at: <https://www.ea.govt.nz/assets/dms-assets/27/MDAG-review-of-trading-conduct-provisions-recommendations-paper.pdf>

¹⁸ See MDAG’s Discussion Paper [online] Available at: <https://www.ea.govt.nz/assets/dms-assets/26/26404High-Standard-of-Trading-conduct-MDAG-discussion-paper-on-pivotal.pdf>

Submitter	Submitter feedback	Authority's response
Trustpower	Risk of multiple and vexatious allegations remains	<p>The Authority considers this prospect to be remote because clauses (2)(i) and (ii) of the proposed rule make it clear that the conduct provisions are intended to act as a backstop rather than supplanting normal competition.</p> <p>The Authority also has some level of discretion in deciding whether to progress any alleged breach to a full investigation¹⁹. It would only do so if it considered that a claim had solid grounds.</p>
Meridian	The CBA excludes the cost of unintended consequences, namely the deterrence of efficient behaviour by the proposed rule.	<p>The Authority disagrees that the proposed rule would deter efficient behaviour and on the contrary, the CBA clearly shows that the proposed rule will actually lower the risk of adverse unintended efficiency impacts compared to the status quo.</p> <p>Under the current high standard of trading conduct provisions, there is a conceivable risk that future enforcement actions will not fully account for all relevant economic factors and that there is no guarantee that decision-makers will even use an economic efficiency lens. Therefore, under these provisions, there is a real risk of unintended economic efficiency effects.</p> <p>With the proposed rule, this risk is likely to be lower because it has much clearer provisions and explicitly accounts for efficiency in its application through reference to net adverse effect.</p>
Various proposals for textual changes to the rule:		
Meridian	Delete "it is expected" from clause (1)(a) to improve the drafting and avoid imbuing the Code with sentiments.	The use of "it is expected" in its passive tense refers to the expectation in the spot market and is used to highlight a key underlying assumption ie, that offers [in the spot market] will generally be subject to competitive disciplines. This statement should not be misunderstood as referring to the expected offer behaviour of any specific participant or participants.
Meridian	Replace "at the point of connection to the grid and in the trading period to which the offer relates" with "in the relevant market" to avoid an overly narrow definition of market.	Reference to where and when the offer relates to (ie, at the point of connection to the grid and in the trading period) adds certainty to the rule and makes it easier to interpret. Replacing this statement with 'in the relevant market' would leave it open to interpretation and, in case of a breach allegation, it could potentially be interpreted differently by the parties involved.
Meridian	Delete sub-clause (3)(a) because it is awkwardly drafted in that it seeks to define significant market power by reference to (non-significant) market power, in a manner that is inconsistent with the case law relating to the definition	<p>The Authority considers it important to provide direct reference to when market power becomes significant as set out in Clause (3)(a).</p> <p>A party that is able to exercise market power in a manner that is detrimental to economic efficiency at levels of aggregation beyond the node at which they are</p>

¹⁹ Regulation 11(1)(c) of the Electricity Industry (Enforcement) Regulations 2010

Submitter	Submitter feedback	Authority's response
	of a market, or identification of a position of market power in that market.	operating will also have the ability to do this at its individual node.
Trustpower	<p>Replace sub-clauses (1)(a) and (b) with a single clause that would apply to offers (and reserve offers) when not subject to competitive disciplines. This proposal is needed because:</p> <p>(1) the word 'accordingly' may be misconstrued as applying to both clauses (1)(a) and (1)(b) (rather than (1)(a) only); and</p> <p>(2) other sections of the Code may also rely on the assumption in 1(a) and its express inclusion might have implications for the future interpretation of those other sections.</p>	<p>The Authority understands Trustpower's desire for more certainty and tighter boundaries around when the rule does and does not apply. The new rule imposes a counterfactual test. By definition this requires consideration of hypothetical scenarios, which can be complex. As previously stated by MDAG, "<i>the boundary between sufficient and insufficient competition is inescapably a matter of judgement, not a mechanical formula. If in doubt, compliance with the proposed rule is available by market participants acting on the assumption that they face vigorous competition</i>".</p> <p>Trustpower's proposed amendment seems to be imposing a new test to the rule, namely whether there is sufficient competition when offers are made. This would appear to be akin to a safe harbour whereby if no generator is pivotal, then the test in clause 2 [or the rule] does not apply. This is not the Authority's intention. The core test is laid out in clause (2) where a generator's offer must be consistent with offers made if no generator could exercise significant market power.</p>
Independent Retailers	The test of when market power becomes significant should include when it would "otherwise cause harm to consumers" to link the definition of when market power becomes significant more closely to all three limbs of the Authority's statutory objective.	<p>The central objective of the proposed rule is to improve price efficiency in the wholesale electricity spot market (the third limb). Although this is not the same as the other two limbs (competition and supply reliability), it is nonetheless expected to also contribute to these objectives as set out in the Consultation paper's regulatory statement²⁰.</p> <p>By excluding "otherwise cause harm to consumers" or statements to this effect mitigates the risk of being misconstrued as also including distributional elements, which is not in the Authority's statutory objectives.</p>
Trustpower	Provide a period of compliance leniency once the new rules come into force	The Authority has some discretion in monitoring, investigating and enforcing compliance as set out in the Authority's Enforcement and Prosecution Policies. The Authority is likely to take a pragmatic approach when determining whether and how to proceed with a breach allegation and it will likely take into consideration if it is a first-time breach of the new rule subject to the seriousness of the breach allegation and the potential for harm to consumers.
Meridian, Trustpower, Contact	Provide guidelines or educational material or anonymised information on the findings of cases that have been considered but not progressed - to	The Authority encourages market participants to familiarise themselves with the substantial body of work developed by the MDAG in their review of the trading conduct provisions. The Authority is synthesising this

²⁰ See Section 6 of the Consultation Paper [online] Available at: <https://www.ea.govt.nz/assets/dms-assets/27/Consultation-paper-Trading-conduct-v4.pdf>

Submitter	Submitter feedback	Authority's response
	facilitate the interpretation and application of the rule.	<p>body of work in a series of FAQs that will be made available on the website.</p> <p>The Authority will publish its approach to monitoring and is considering providing access to anonymised information on compliance actions not currently made publicly available .The Authority will make readily available any decisions by the Rulings Panel or the courts to further firm up the rule.</p>

Appendix B Submitters' suggested amendments to the proposed rule

B.1 This Appendix reproduces in full the suggested amendments to the proposed rule by the Independent Retailers, Meridian and Trustpower (additions are underlined and deletions are struck through).

B.2 Suggested amendment by the Independent retailers

- (1) In the spot market –
 - (a) it is expected that **offers** and **reserve offers** will generally be subject to competitive disciplines such that no party has significant market power;
 - (b) however, there may be locations where, or periods when, one or more generators, or ancillary service agents, as the case may be, has significant market power.
- (2) Accordingly –
 - (a) where a **generator** submits or revises an **offer**, that offer must be consistent with the **offer** that the **generator**, acting rationally, would have made if no **generator** could exercise significant market power at the **point of connection** to the **grid** and in the **trading period** to which the **offer** relates;
 - (b) where an **ancillary service agent** submits or revises a **reserve offer**, that **offer** must be consistent with the **reserve offer** that the **ancillary service agent**, acting rationally, would have made if no **ancillary service agent** could exercise significant market power at the **point of connection** to the **grid** and in the **trading period** to which the **reserve offer** relates;
- (3) For the purposes of this clause –
 - (a) market power becomes significant when its exercise would have a net adverse impact on economic efficiency, which includes productive, allocative and dynamic efficiency, or otherwise cause harm to consumers
 - (b) “spot market” has the same meaning as **wholesale market** except that it excludes the hedge market for **electricity** (including the market for **FTRs**).

B.3 Suggested amendment by Meridian

- (1) In the spot market –
 - (a) ~~it is expected that~~ offers and reserve offers will generally be subject to competitive disciplines such that no party has significant market power;
 - (b) however, there may be locations where, or periods when, one or more generators, or ancillary service agents, as the case may be, has significant market power.
- (2) Accordingly –
 - (a) where a generator submits or revises an offer, that offer must be consistent with the offer that the generator, acting rationally, would have made if ~~it no generator~~ could **not** exercise significant market power **in the relevant market at the point of connection to the grid and in the trading period to which the offer relates;**
 - (b) where an **ancillary service agent** submits or revises a **reserve offer**, that **offer** must be consistent with the **reserve offer** that the **ancillary service agent**, acting rationally, would have made if ~~it no ancillary service agent~~ could **not** exercise significant market power **in the relevant market at the point of connection to the grid and in the trading period to which the reserve offer relates;**
- (3) For the purposes of this clause –
 - (a) ~~market power becomes significant when its exercise would have a net adverse impact on economic efficiency, which includes productive, allocative and dynamic efficiency;~~
 - (b) “spot market” has the same meaning as wholesale market except that it excludes the hedge market for electricity (including the market for FTRs).

B.4 Suggested amendment by Trustpower

~~(1) In the spot market –~~

~~(a) (1) it is expected that This clause applies where **offers** and **reserve offers** will generally are not subject to competitive disciplines because there may be locations where, or periods when, one or more generators, or ancillary service agents, as the case may be, such that no party has have significant market power;~~

~~(b) however, there may be locations where, or periods when, one or more generators, or ancillary service agents, as the case may be, has significant market power.~~

(2) In circumstances when this clause applies:

(a) where a **generator** submits or revises an **offer**, that offer must be consistent with the **offer** that the **generator**, acting rationally, would have made if no **generator** could exercise significant market power at the **point of connection** to the **grid** and in the **trading period** to which the **offer** relates;

(b) where an **ancillary service agent** submits or revises a **reserve offer**, that **offer** must be consistent with the **reserve offer** that the **ancillary service agent**, acting rationally, would have made if no **ancillary service agent** could exercise significant market power at the **point of connection** to the **grid** and in the **trading period** to which the **reserve offer** relates;

(3) For the purposes of this clause –

(a) market power becomes significant when its exercise would have a net adverse impact on economic efficiency, which includes productive, allocative and dynamic efficiency;

(b) “spot market” has the same meaning as **wholesale market** except that it excludes the hedge market for **electricity** (including the market for **FTRs**).

Glossary of abbreviations and terms

Authority	Electricity Authority
Act	Electricity Industry Act 2010
CBA	Cost-Benefit Analysis
Code	Electricity Industry Participation Code 2010
MBIE	Ministry for Business, Innovation and Employment
MDAG	Market Development Advisory Group
UTS	Undesirable Trading Situation
WAG	Wholesale Advisory Group